STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	**:**	
	:	
Proposed general increase for	**:**	**Docket No. 14-0066**
Electric service	**:**	

MidAmerican Energy Company's Reply Brief on Exceptions

Table of Contents

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MidAmerican Energy Company	:	
	:	
Proposed general increase for Electric service	:	**Docket No. 14-0066**
	:	

MIDAMERICAN ENERGY COMPANY'S REPLY BRIEF ON EXCEPTIONS

NOW COMES MidAmerican Energy Company ("MidAmerican") and respectfully submits its Reply Brief on Exceptions pursuant to the Administrative Law Judge's ("ALJ") Proposed Order of September 4, 2014 ("Proposed Order"), and Section 200.830 of the Rules of Practice of the Illinois Commerce Commission ("Commission"), 83 Ill. Adm. Code § 200.830, in the above-captioned proceeding.

I. INTRODUCTION

As noted in MidAmerican's Brief on Exceptions, the Proposed Order correctly recommends that the Commission reject Illinois Commerce Commission Staff's ("Staff") proposal to disallow approximately $70,000 in rate case expenses associated with MidAmerican's return on equity witness and also correctly concludes steam and distribution maintenance are reasonable operating expenses. Staff's Brief on Exceptions challenges the Proposed Order's determination on rate case expenses despite the record evidence supporting the findings and conclusions. The Department of Defense and all other Federal Executive Agencies ("DOD/FEA") challenges the Proposed Order's findings on steam production and distribution maintenance expenses despite the record evidence supporting these findings and conclusions.

DOD/FEA also proposes unsupported changes to the return on equity section. As addressed further below, the Commission should reject these proposed changes.

In addition to these contested issues, Staff suggests additional non-substantive exceptions that MidAmerican does not oppose and leaves to the Commission's discretion whether to adopt them.

MidAmerican presents its reply to these issues in the order presented in the agreed-upon brief outline during the post-hearing brief phase of this docket.

II. Rate Base

B. Uncontested adjustments to MidAmerican's proposal

Staff Exception 1

1. Accumulated Deferred Income Tax Related to FAC

Staff proposes to add additional language to the proposed order regarding the Accumulated Deferred Income Tax ("ADIT") related to the fuel adjustment clause. Staff BOE at 2. MidAmerican does not oppose Staff's additional language and will leave it to the discretion of the ALJ and the Commission to adjust the final order accordingly.

Staff Exception 2

2. Planned Retirement of Generation Stations

Staff proposes to add additional language to the proposed order regarding the agreed upon reporting for the planned retirement of generation plants. Staff BOE at 3. MidAmerican does not oppose Staff's additional language and will leave it to the discretion of the ALJ and the Commission to determine if it is necessary to adjust the order accordingly. MidAmerican notes, however, that the portion of the sentence following Staff's added language in the last paragraph does not appear to be needed any longer and should be deleted.

III. Revenue Requirement – Operating Revenues and Expenses

A. Contested adjustments to MidAmerican's proposal

DOE/FEA Exception

1. Steam Production

DOD/FEA takes exception to the Proposed Order's finding regarding MidAmerican's steam maintenance expense. DOD/FEA BOE at 6. Despite the fact that MidAmerican proposed an adjustment to remove labor expenses from the maintenance expense, DOD/FEA still opposes the Proposed Order's findings, and suggests language that contradicts the Illinois jurisdictional allocation process. As DOD/FEA's proposed language is presented, the Commission would approve an adjustment based on total Company labor costs, rather than the Illinois jurisdictional amount. DOE/FEA BOE at 7. This language is not supported by the record evidence and contravenes past Commission practice to allocate costs based on jurisdiction.

As noted in the briefing phase, MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's coal units by adjusting test year values to five-year average values. MidAmerican Ex. RRT 1.0 at 7, ll. 125-131; MidAmerican IB at 41-42. MidAmerican agreed with the DOD/FEA position that there is an element of duplication with the adjustments for steam production maintenance for labor and the payroll pro forma adjustment to the extent of the labor costs that are embedded in steam production maintenance. Accordingly, MidAmerican proposed a modification to the payroll tax adjustment to remove any escalation associated with payroll charged to steam production maintenance. MidAmerican Ex. RRT 2.0, at 7, ll. 119-124; MidAmerican IB at 41-42. Staff agreed with MidAmerican's adjustment. Staff Ex. 12 at 2, ll. 45-46; at 18-19, ll. 407-411.

MidAmerican explained maintenance costs for MidAmerican's coal generation facilities can vary significantly from year to year depending upon where each of the units is with respect to its major maintenance cycle and the extensiveness of the maintenance performed. Five years was selected as the normalization period since these units are generally on a five-year cycle for major overhaul work. MidAmerican Ex. RRT 1.0 at 7, ll. 125-131.

MidAmerican included an inflation factor because a five year average of actual costs reflects changes in the level or work activity, but ignores changes in cost levels for the work being performed over that period of time. MidAmerican Ex. RRT 1.0 at 7, ll. 133-134. Therefore, MidAmerican relied on the Handy-Whitman index in its calculations of these costs. Since the calculation was an average, the change in the index over the five years was averaged as well. *Id*. at 135-139.

The Proposed Order properly determines that normalizing steam production maintenance costs is appropriate and reasonable. Proposed Order at 25, *see also* MidAmerican Ex. RRT. 2.0 at 4, ll. 60-61; Staff Ex. 3.0 at 5. DOD/FEA, however, continues to recommend the Commission reject the normalization of steam production costs. This position fails to consider that the normalization of costs has been a long-accepted practice by the Commission and is relevant for the types of costs that are volatile from year-to-year, as is the case with steam production costs. DOD/FEA's argument is unsupported by the record evidence and DOD/FEA's recommendation to exclude these normalization adjustments should be rejected. RRT 3.0 at 6, ll. 111-115.

DOD/FEA continues to suggest that internal labor should not be considered for normalization and should be segregated from non-labor costs in the evaluation, but provides no rationale for such segregation. The fact is that labor costs are interchangeable with contractor costs and should not be segregated for the pro forma adjustment. Moreover, in the years where steam production maintenance costs are unusually high, labor costs are also high, in part due to high amounts of overtime associated with the work. In both situations, time is of the essence for completion of the work and overtime pay is routinely incurred. RRT 3.0 at 6-7, ll. 119-130.

The Proposed Order correctly weighed the evidence and determined that the methodology to normalize these costs proposed by MidAmerican, as adjusted by Staff, is a reasonable approach to achieve such normalization for steam production costs. Accordingly, in keeping with the traditional treatment the Commission has relied upon in ratemaking treatment of steam production maintenance costs, the Commission should uphold the Proposed Order's determination regarding steam production maintenance costs.

DOE/FEA Exception

2. Distribution Maintenance

DOD/FEA also takes exception to the Proposed Order's finding regarding MidAmerican's distribution maintenance expense. DOE/FEA BOE at 5. Despite the fact that MidAmerican proposed an adjustment to remove labor expenses from the maintenance expense, DOD/FEA still opposes the Proposed Order's findings, and suggests language that contradicts the Illinois jurisdictional allocation process. As DOE/FEA's proposed language is presented, the Commission would approve an adjustment based on total Company costs, rather than the Illinois jurisdictional amount. DOE/FEA BOE at 6. This language is not supported by the record evidence and contravenes past Commission practice to allocate costs based on jurisdiction.

As noted in the briefing phase, MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's electric distribution system by adjusting test year values to five-year average values. MidAmerican Ex. RRT 2.0, at 8, ll. 142-149; MidAmerican IB at 43. MidAmerican agreed with the DOD/FEA position that there is an element of duplication with the adjustments for distribution maintenance labor and the payroll pro forma adjustment to the extent of the labor costs that are embedded in distribution maintenance costs. Accordingly, MidAmerican proposed a modification to the payroll tax adjustment to remove any escalation associated with payroll charged to distribution maintenance. MidAmerican Ex. RRT 2.0 at 7, ll. 119-124. Staff agreed with MidAmerican's adjustment. Staff Ex. 12 at 2, ll. 45-46; at 14-15, ll. 320-328; at 16, ll. 364-368.

MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's electric distribution system by adjusting test year values to five-year average values. Distribution costs can vary significantly from year to year due to the occurrence of storms, flooding or other unpredictable circumstances. A multi-year average of such costs smooths the impact of such occurrences. Five years was used to be consistent with the approach used with steam maintenance. A distribution plant inflation index was used in the calculation for the same reasons outlined above for steam maintenance. MidAmerican Ex. RRT 2.0, at 8, ll. 142-149.

MidAmerican included an inflation factor because a five year average of actual costs only reflects changes in the level or work activity, but ignores changes in cost levels for the work being performed over that period of time. MidAmerican Ex. RRT 1.0 at 7, ll. 133-134. Therefore, MidAmerican relied on the Handy-Whitman index in its calculations of these costs. Since the calculation was an average, the change in the index over the five years was averaged as well. *Id.* at ll. 135-139.

The Proposed Order properly concludes that normalizing steam production maintenance costs is appropriate and reasonable. Proposed Order at 27-28, *see also* MidAmerican Ex. RRT. 2.0 at 4, ll. 60-61; Staff Ex. 3.0 at 5. The DOD/FEA, however, continues to recommend the Commission reject the normalization of distribution maintenance costs. This position fails to consider that the normalization of costs has been a long-accepted practice by the Commission and is relevant for the types of costs that are volatile from year-to-year, as is the case with distribution maintenance costs. DOD/FEA's recommendation to exclude these normalization adjustments is unsupported by the record evidence and should be rejected. RRT 3.0 at 6, ll. 111-115.

DOD/FEA continues to suggest that internal labor should not be considered for normalization and should be segregated from non-labor costs in the evaluation, but provides no rationale for such segregation. DOD/FEA BOE at 5. The fact is that labor costs are interchangeable with contractor costs and should not be segregated for the pro forma adjustment. Moreover, in the years where maintenance costs are unusually high, labor costs are also high, in part due to high amounts of overtime associated with the work. In both situations, time is of the essence for completion of the work and overtime pay is routinely incurred. RRT 3.0 at 6-7, ll. 119-130.

The Proposed Order correctly weighed the evidence and determined that the methodology to normalize these costs proposed by MidAmerican, as adjusted by Staff, is a reasonable approach to achieve such normalization for distribution maintenance costs. Accordingly, in keeping with the traditional treatment the Commission has relied upon in ratemaking treatment of steam production maintenance costs, the Commission should uphold the Proposed Order's determination regarding distribution maintenance costs.

Staff Exception 3

3. Rate Case Expenses

Staff contends that the Proposed Order "incorrectly allows MEC to recover $70,000 in rate case costs for a Return on Equity witness." Staff BOE at 6. Staff contends that the scope of work in the Iowa proceeding is not the same as in the Illinois proceeding. *Id*. 6-7. This position, however, is contrary to Staff's testimony and record evidence.

Staff does not dispute record evidence that services for cost of capital studies, testimony, data request responses and litigation provided by Dr. Vander Weide for the Illinois case are consistent with the scope of work discussed in the engagement letter. Tr. 65, ll. 5-13. On cross examination, Mr. Kahle acknowledged that the services were the same other than the fact the engagement letter referenced Iowa. Tr. 65, ll. 5-13.

As noted in testimony and briefing stage, MidAmerican has had a long relationship with the outside witness, Dr. Vander Weide. MidAmerican Ex. DAC 2.0 at 5, ll. 76-77. MidAmerican IB at 49. The cost per hour on the invoices for the Illinois work is the same price as the Iowa engagement letter proving that Dr. Vander Weide is charging that same price that MidAmerican approved with the oral amendment. This was verified when Staff witness McNally reviewed Dr. Vander Weide's invoices and Mr. McNally did not propose any adjustments in his direct testimony. Staff Ex. 6.0 at 17, ll. 344-349. Moreover, during cross examination, Staff witness Kahle also verified the expenses for the outside witness were consistent with the engagement letter. Tr. at 59, ll. 3-25 through 60, ll. 1-14. Staff witness Kahle also agreed on cross examination that it is typical for utilities to engage an outside witness for ROE issues and also acknowledged that Dr. Vander Weide's work was not duplicated by MidAmerican personnel. Tr. 57, ll. 4-12.

In this case, MidAmerican demonstrated that the amendment to include Illinois return on equity testimony was not significant enough to change either MidAmerican's obligations or Dr. Vander Weide's obligations under the contract. The performance for the Illinois rate case was identical to the performance for the Iowa cases. Additionally, there is no issue that the contract clearly defines the scope of work and the fee and specifies the dollar per hour for services and reimbursement of expenses. MidAmerican expected and has paid for his services in accordance with the rates specified in that agreement. As noted above, Staff confirmed that the services performed by Dr. Vander Weide were consistent with the terms set forth in the engagement letter. Tr. at 59, ll. 3-25 through 60, ll. 1-14.

Therefore, there is no issue in this case that the performance of this work was consistent with the contract. The record demonstrates there was a contract in place for Dr. Vander Weide, Staff agreed on cross examination that engagement letter for Dr. Vander Weide's services being provided, cost of capital studies, testimony, data request responses and litigation for the Illinois case are consistent with the scope of work discussed in the engagement letter. While Mr. Kahle acknowledged that the services were the same other than the fact the engagement letter referenced Iowa, this is not a reason to deny the rate case expense. Based on Illinois law and the record evidence, there is no basis upon which the Proposed Order's finding on this issue should be changed.

IV. Rate of Return

A. Cost of Common Equity

DOD/FEA Exception

DOE/FEA takes issue with the Proposed Order's description of the DOD/FEA comparable risk proxy group as being similar to MidAmerican. DOD/FEA BOE at 1. DOD/FEA points out the proxy group Mr. Gorman used for his Discounted Cash Flow model ("DCF") and Capital Asset Pricing Model ("CAPM") meets the criteria for an appropriate comparable risk selection. DOD/FEA BOE at 2. MidAmerican agrees that the proxy groups used by both MidAmerican and DOD/FEA are appropriate comparable risk selections and may be considered by the Commission. MidAmerican, however, disagrees with the DOE/FEA's argument that its "reasonable" proxy group leads to the conclusion that DOD/FEA's return on equity ("ROE") recommendation corroborates the results of Staff's ROE studies. DOD/FEA BOE at 3.

As MidAmerican pointed out in its initial brief, the DOD/FEA DCF analysis includes two other DCF models, the multi-stage growth and the sustainable growth models, upon which the Commission does not generally rely. MidAmerican IB at 58-59. Moreover, DOD/FEA conceded that the Commission's standard practice is to use the quarterly DCF model, although DOD/FEA disagrees with the Commission's standard practice. DOD Ex. 1.0 at 13, ll. 278-289.

Additionally, DOD/FEA acknowledged that its CAPM analysis is "conservative" and employs a risk free rate much lower than Value Line and the Energy Information Administration's forecasted risk free rate of 5.17%. MidAmerican Ex. JHV 2.0 at 27, ll. 567-577. Furthermore, DOD/FEA's CAPM recommendation does not take into consideration that the CAPM underestimates the cost of equity for companies with betas less than 1.0, and hence underestimates MidAmerican's cost of equity. MidAmerican IB at 60. Consequently, the Proposed Order correctly rejects the DOD/FEA ROE recommendations because DOD/FEA used two additional DCF models the Commission does not generally rely upon and a risk free rate that underestimates the projected growth for the CAPM, all resulting in a recommended ROE that underestimates MidAmerican's ROE. This result does not corroborate Staff's finding, but rather underestimates the ROE and results in an unreasonable ROE. Therefore, the Commission should reject DOE/FEA's proposed changes.

V. Cost Allocation and Rate Design

A. Uncontested Issues

Staff Exception 4

1. Rate Design

Staff proposes to add additional language to the proposed order regarding rate design. Staff BOE at 11-12. MidAmerican does not oppose Staff's additional language and will leave it to the discretion of the ALJ and the Commission to adjust the order accordingly.

VI. Tariff Revisions

Staff Exception 5

1. Reconnection Fee

Staff proposes to strike the reconnection fee section and add additional language to the proposed order regarding the reconnection fees. Staff BOE at 12. MidAmerican does not oppose Staff's additional language and notes that the current language could also be retained. MidAmerican will leave it to the discretion of the ALJ and the Commission to adjust the order accordingly.

VII. Conclusion

For the reasons set forth above and reflected in the record, MidAmerican's initial and reply briefs, its proposed draft order, and brief on exception MidAmerican Energy Company respectfully requests that the Commission adopt MidAmerican's Exceptions to the Proposed Order and enter findings and make conclusions consistent with the positions set forth in MidAmerican's Exceptions.

WHEREFORE, MidAmerican Energy Company respectfully requests that the Illinois Commerce Commission issue an Order approving MidAmerican's rate application, as modified and consistent with MidAmerican's Exceptions and Appendix A filed in this docket on September 25, 2014.

DATED this 9th day of October, 2014.

Respectfully submitted,

MIDAMERICAN ENERGY COMPANY

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